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USWEST

Glenn Brown
Executive Director-
Public Policy

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April 16, 1996

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street N.W., Suite 222
Washington, D.C. 20554

RE: CC Docket 96-45

Dear Mr. Caton:

Attached hereto are two copies of a letter that was delivered today to Mr. Richard Metzger concerning a decision issued in U S WEST's Washington State rate case proceeding.

In accordance with Commission Rule 1.1206(a)(1), two copies of the letter are being filed with you for inclusion in the public record. Acknowledgment and date of receipt are requested. A copy of this transmittal letter is provided for this purpose. Please contact me if you have questions.

Sincerely,



Attachments

CC: Joint Board Commissioners
Joint Board Staff

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Glenn Brown
Executive Director-
Public Policy

April 16, 1996

Mr. Richard Metzgar
Deputy Chief - Common Carrier Bureau
Federal Communications Commission
1919 M Street N.W., Room 500
Washington, DC 20554

Dear Mr. Metzgar:

At the meeting of the Joint Board on Universal Service on April 12, 1996, Commissioner Sharon Nelson of the Washington Utilities and Transport Commission (WUTC) announced a recent decision which they had issued in U S WEST's rate case proceeding. She stated that in this decision they had found that the \$10.50 price for basic residential service was above the cost of providing that service. You requested that I provide you with a copy of that decision, which I have attached to this letter.

U S WEST strongly disagrees with many aspects of this decision. I have also attached the statement of Dennis Okamoto, U S WEST Vice President - Washington, responding to the order in general. Of particular relevance to the universal service proceeding are the conclusions which the Washington Commission reaches concerning the cost of providing basic residential service.

On Page 7 of their decision the WUTC states:

"[T]he incremental cost of local service is less than \$5 per month. Even if the entire incremental cost of the "loop" -- the facilities needed for the connection between the central office and the consumer's telephone which also carry long distance and specialized services, such as voice mail, as well as local service -- is allocated to the local rate payer the price covers that cost. There simply is no local service subsidy."

The WUTC bases its conclusions on a cost study done by Hatfield and Associates which was submitted by AT&T and supported by MCI. They further make the amazing assumption that the "incremental" cost of the local service does not include the local loop. The incremental cost of local service is then computed by taking the total cost which Hatfield develops for local service -- \$13.38 per month -- and subtracting the cost which Hatfield develops for the local loop component of this cost -- \$8.96 per month. The result of this subtraction is \$4.42 per month.

In describing the Hatfield model, the WUTC states that the model "...incorporates elements of the Benchmark Cost Model (BCM) which has been presented to the FCC by U S WEST Communications and others." U S WEST is concerned that recently there have been allusions that since the Hatfield study incorporates elements of the BCM, that U S WEST somehow supports the Hatfield model. We do not.

For over a year, U S WEST has worked in good faith with MCI and the other "Joint Sponsors" (NYNEX and Sprint) to develop a consensus approach to estimating the investment required to serve different customers. The results of this work are reflected in the Benchmark Cost Model (BCM) which was placed on the record in CC Docket 80-286. In areas where we could not reach agreement with MCI, such as the appropriate expense factors to apply to investment to develop the monthly cost of service, we included two estimates for this factor and "agreed to disagree". We also had an agreement among the Joint Sponsors that if one Sponsor were to change any of the assumptions or factors in the model that they could not represent the results as being supported by the other Joint Sponsors.

In our joint filing of BCM results submitted to the FCC on December 1, 1995, the following data for the cost of basic residential service was presented for the State of Washington:

Using U S WEST's expense factor:	\$23.48/month
Using MCI's expense factor:	\$17.02 /month

In the transmittal letter for the BCM results, the following statement appears: "The Joint Sponsors support the use of the BCM for the analysis of the targeting of explicit high cost support. They do not agree on its use for other purposes such as the setting of rates for telephone service." This statement was included in the transmittal for good reason. In the Executive Summary, the purpose of the study is stated to be "...to identify areas where the cost of service can reasonably be expected to be so high as to require explicit high cost support for the preservation of Universal Service." The summary states that the model does not produce the actual cost of service but rather "...the relative costs of serving customers residing in given areas...". Because it was built for this purpose, some elements of the cost of service which would not vary in different geographic areas were not included. Also, in extremely dense urban areas there are additional cost factors which we did not attempt to measure since it was assumed that no high cost support would be provided to such areas.

On February 21, 1996 the Joint Sponsors made an ex-parte filing outlining proposed enhancements to the BCM. In this filing we described what had been learned through four BCM workshops and the comment and reply rounds (including the understatement of urban costs) and listed the following elements of network cost which were not included in the initial BCM analysis (e.g., Drop, Pedestal, Cross-Connects, Engineering, Splicing, Inter-office Trunking, Riser Cable and Terminal Vaults). The Joint sponsors have agreed that some (but not all) of the omitted network elements would be included in the next version of the BCM. By omitting key elements of network cost, the December 1, 1995 BCM results would tend to underestimate total costs, particularly in urban areas.

At the same time that MCI was working with U S WEST on the BCM, they were also working with AT&T and Hatfield and Associates to develop the Hatfield study. The Hatfield study incorporates some elements and algorithms of the BCM, but makes a number of changes in key BCM assumptions and algorithms which differ significantly from the consensus assumptions and algorithms developed by the Joint Sponsors. As demonstrated above, the results of these changes have a profound impact on the results of the study.

Mr. Richard Metzger
Federal Communications Commission
Page 3

In order that there be no confusion in the upcoming Joint Board proceeding on universal service, we feel that it is important to state that the Hatfield study is not the BCM, and in no way does U S WEST support or endorse the Hatfield study or its results.

We are further concerned by the statement of the WUTC that "There simply is no local service subsidy." Using any value for the "average" cost of basic residential service implies that individual customers will be both above and below this level. We believe that the BCM offers a valuable tool to identify areas where the cost of local service is above a level which is determined to be affordable, and to design targeted support mechanisms to benefit customers living in these areas. Both the Communications Act of 1996 and the FCC's NPRM in CC Docket 96-45 correctly recognize that there is a significant subsidy to local service in rural, insular and high cost areas which must be addressed as local competition is introduced.

One final comment concerning the relationship between the results of the BCM and the cost of preserving affordable universal service must be made. The BCM develops the cost of duplicating the present LEC network using current technology and efficient network design. Incumbent carriers, such as U S WEST, have carried the obligation of providing universal service for many decades. Investments made in earlier years, utilizing the most efficient technology of that time, are legitimate costs which we are entitled to recover. The fact that, for the most part, regulators have not allowed us to depreciate this plant at rates anywhere near the pace at which technology has changed, makes the job of recovering these investments even more challenging for us and our regulators. Through an appropriate combination of targeted explicit support mechanisms and rate rebalancing, state and federal regulators must find appropriate solutions to the preservation of universal service at a time when the market economics of the local exchange industry are undergoing radical change. The BCM is but one tool in the targeting of support, and it represents only one part of sizing the problem which regulators must address if local competition is to evolve in the public interest.

Sincerely,

A handwritten signature in black ink, appearing to read "R Metzger", with a long horizontal flourish extending to the right.

cc: Joint Board Commissioners (Letter only)
Joint Board Staff (Letter only)